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As I See It! — Why Is Private Equity Interested In Publishing?

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At the end of a tumultuous year in which no fewer than three of the top four textbook publishers changed hands, and two of them were acquired by private equity firms, it is time to reflect on the significance of private equity ownership in scholarly, and academic publishing. Why are investors interested in academic, scholarly and educational publishing?

During 2007 **Wolters Kluwer** sold its educational publishing unit to **Bridgepoint**, and **Thomson** sold **Thomson Learning** to **Apax Partners** and **OMERT**, who renamed it **Cengage Learning**. **Reed Elsevier** sold **Harcourt Education** in two parts; its international business was bought by **Pearson**, while its US business was acquired by **Houghton Mifflin**. Subsequently, **Houghton Mifflin** sold its college textbook division to **Cengage**.

Private equity has recently been active in the textbook segment of the publishing industry. It is already a significant presence in scholarly publishing, as **Springer** is owned by private equity. This sort of publishing is not subject to the “boom and bust” of the consumer economy. It is funded mainly from public expenditure and related to educational and research activity that is necessary regardless of the state of the wider economy. In other words, its very stability is attractive as an investment. So what is “private equity,” and why has it been transformed from small-scale investment to a major engine of our economy?

“Private equity” is the name we coined for venture capital when it outgrew its origins as a source of financing for small start-up companies. Private equity firms are now huge. They are partnerships or corporations funded by pension funds, mutual funds, insurance companies, and private investors. They are professionally managed, and now control household names that once we would have expected to find listed on the **Stock Exchange**.

Venture capital originated as a source of funding for new or rapidly growing companies. It was the financial engine of innovation. Venture capital firms would assume high risks. They would work in partnership with the management, combining their experience of business and financial management with the innovative skills and entrepreneurial zeal of the management. Inevitably, some of their investments would fail, so they reduce their overall risk by investing in a portfolio of young companies. Many major corporations — including **Microsoft**, **Federal Express**, and **Intel** — began as venture capital investments.

This model has been extended to investment in much larger companies. The big private equity firms invest in businesses that they can transform into better, more profitable entities, which they can sell on. One of the most common models is for private equity to back a management buy-out, or assemble a management team and financial backing to acquire a business that has been put up for sale. The objective is to “improve shareholder value” or, put simply, make a profit.

Unlike stock market investors, who are held at arm’s length from the management of the company in which they have shares, private equity investors work closely with management, who themselves invest in the company and have a stake in its success, to grow the business by improving the company’s performance, operations and strategic direction. The largest current example in our community is **Springer**, which is owned by two UK-based private equity firms, **Cinven** and **Candover**. They invested in **Springer**, and installed new management, when the previous owner, **Bertelsmann**, decided to discontinue its involvement in academic and scholarly publishing.

My own personal experience of private equity came about when **Carfax** was acquired by **Routledge** in 1997. **Routledge** had previously itself been acquired from **Thomson** by **Cinven**. **Cinven** was represented on the **Routledge** Board of Directors, and played a strong role in the financial management of the company. Otherwise, as the **Cinven** directors themselves said, they employed senior management to run the publishing business and were not going to interfere in publishing decisions. They brought a financial discipline to our deliberations, and were constructive and supportive in our Board discussions. I am sure that their approach is entirely typical.

Private equity is an alternative form of investment to stock markets. It is not better or worse than investing in quoted shares; it is simply different. The two forms complement each other. Many private equity-backed companies go on to be publicly-quoted companies. However, it has to be said that private equity grew significantly as a consequence of the accounting controls and other governance regulations heaped on publicly-quoted companies as a result of the **Enron** and other similar corporate and financial scandals — particularly,

in the USA, the **Sarbanes-Oxley Act of 2002**. **Sarbanes-Oxley** has placed onerous controls and reporting requirements on publicly quoted companies that have been criticized as intrusive

and costly to administer. It has certainly made private equity ownership a more attractive proposition as it is not subject to the same intense scrutiny. Although not directly affected by **Sarbanes-Oxley**, UK investment in private equity-backed businesses has been above the national average. According to the **British Venture Capital Association**, the UK private equity trade association, in the five years up to 2005-06 investment in private equity-backed companies rose by 18 percent, as against the national average of one percent.

How do private equity investors make money? Put simply, they sell the business for more than they paid for it. They choose the moment to sell (or, as it is known in the trade, “exit”) either by backing a **Stock Market** flotation through an **IPO** or by selling the company to another organization.

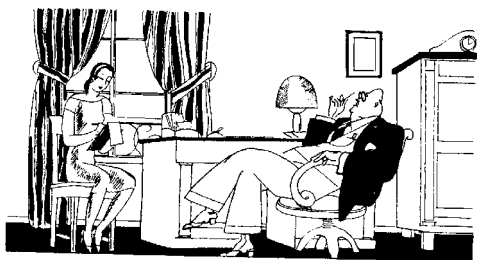
Most companies are financed by shareholders and by debt — the latter in the form of bonds or bank loans. When a private equity firm invests in a company, it invests partly from its own funds and partly by arranging loans, usually from banks. The company pays the interest on the loans. In the case of mature companies with good cash flow, such as academic and educational publishers, the lion’s share of this funding will be in the form of debt; such companies are described as “highly leveraged.”

When the private equity owner sells the company, or realizes its investment through a stock exchange flotation (**IPO**), it first repays the loans. The balance of the purchase price is the profit made by the firm. Such profits can be huge, if the company has grown significantly while under its stewardship. The increase in the value of the company belongs entirely to the private equity firm and the management. So the return on investment for private equity investors can be very high indeed.

Private equity companies have always been shy of publicity — after all, that is what “private” implies. Their activities, and the activities and results of the companies they own, are not publicized, as the disclosure rules under which they operate are different from those applying to publicly quoted companies. As private equity has matured as an industry, its low profile has been interpreted as a lack of transparency. There is now a realization that it needs to become more publicly accountable as it has become a major influence on our economy. Moreover, we ought to be interested in private equity, as it impacts on our pensions and our savings in mutual funds and insurance policies.

The taxation of private equity firms has become a matter of controversy. As corporations, private equity firms are taxed in the same way

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Little Red Herrings — Reading Is, Like, You Know, Sooooo Gross!

by **Mark Y. Herring** (Dean of Library Services, Dacus Library, Winthrop University) <herringm@winthrop.edu>

"*Huge Decline in Book Reading*" ran one headline. "*Cultural Atrophy!*" read another. "*Study Links Drop in Test Scores to a Decline Spent in Reading*" ran one for the "Duh!" award. "*Americans are Closing the Book on Reading*" said one, vying for the pun-acious trophy.¹ Whether the stories reported on the first such study about the decline in reading (as do the first two headlines) or the second such study (as do the last two headlines), the news is equally depressing, lamentable and alarming: reading among young people is dreadful while reading among adults awful. Young people, like, hate to read, you know, like, it's just so, you know like, not awesome, while older people would rather watch "*Survivor*" or "*American Idol*." What may well be more alarming than the study, however, is the near silence of librarians about either the study, the issue, or whether this has any impact at all on what librarians do.



This should come as no surprise, though it is. Since entering the profession now almost thirty years ago, I have been dismayed by the cavalier approach to the importance of reading by our profession. It isn't that we take it for granted. It's that we are hell-bent on making the profession about something else entirely. We want it to be about relationships with "information-seekers" or about the next generation and what that generation wants or needs. We want it to be about data, not about knowledge or, heaven forbid, wisdom. It is as if all such notions are so horribly Western, so embarrassingly not allocentric, that the profession has endeavored to bury reading in an unmarked grave and move on quickly to something else — anything else — as rapidly as possible.

When the **National Endowment for the Arts** released its 2004 report, "*Reading at Risk*," the data were frightening enough. Fewer than half of all Americans over 18 read novels, short stories, plays, or poetry. This year's report is summed up by **Dana Goia**, chairman of the **Endowment**, in a short, concise sentence that most Americans cannot or will not read: the data are "simple, consistent, and alarming." Both reports have their detractors. Some felt that reading was defined in too highbrow a manner in the first report (that changed with the second). Another knucklehead (from

academe, natch) argued that reading had not declined at all; people just read different things in different ways now, whatever that meant. **Nancy Kaplan**, executive director of the **School of Information Arts and Technologies** complains that in the current report data have been massaged and presented in an irresponsible way. Her take (read it here: http://www.futureofthebook.org/blog/archives/2007/11/reading_responsibly_nancy_kaplan.html) essentially argues that the patient, while not breathing, isn't really dead. Moreover, the vital signs from **NAEP (National Assessment of Educational Progress)** and **NAAL (National Assessments of Adult Literacy)**, data sets from which both reports were drawn, are just not all that bad. Of course, **Ms. Kaplan**, in a school of technologies, doesn't want technologies to be blamed. But anyone who has worked with young people at all knows without any doubt that reading, its facility and proficiency has, well, tanked. The new report tackles these issues, defines reading as widely as **Andy Warhol** defined "art" and yet the results are the same. As one of the researchers argued, we can't "nitpick or wrangle" about whether reading is in decline. It is, and the decline is precipitous.

So just how bad is it? While finding at least two hours a day to watch television, 15-24 years olds barely find seven minutes a day on voluntary reading on weekdays and a whopping ten on the weekends. Proficiency is also in decline no matter whether readers are (trying) to read a blog or a can of soup. Whatever Americans choose to read, they are not doing it well or often. If you think I'm being elitist, those Americans with advanced degrees read only marginally better and longer. (For those of you who work in higher education, you know this to be the case!)

Young Americans aren't reading newspapers, newsletters, or, ostensibly, the little packing slip in a new pair of jeans. They do surf the Web, a lot, and some of them have inane, poorly written blogs. **iPods** proliferate, and every child, while not only being a winner, must also have a laptop. We have phones that connect to the Web, will make pictures, and will send msgs tht rd lk ts. We have become the most technologically advanced nation in the world. But we are also a nation of illiterates. It isn't that there will not be books in the future. There will be many books: there just won't be anyone who can read them.

This can't be blamed on young people alone. Reading programs in this country, as I have written in this space before, are idiotic, mind-numbing and gormless. When educators aren't touting the look-say method, they are championing **Whole Language**, two programs that have done more to destroy reading than a million bad books by poetasters or pundits.

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as any other company. This includes tax relief on the interest paid on its loans. However, if a large company is highly leveraged, its debt servicing is effectively being subsidized by taxpayers, while the private equity owners make large profits upon selling the business. Moreover, the tax treatment of private equity executives, at least in the UK, has become controversial; the profits made by them are taxed as capital gains rather than as income, on the basis that they are investing in an unquoted company and making a capital gain. But this means they pay much less tax than the rest of us obliged to pay income tax. And what they do in the office every day does not seem to be any less a regular job than what the rest of us do. The private equity industry has suddenly woken up to the need to be more accountable and more transparent in the way they relate to the community at large.

In 2007 we have seen the beginning of the end of more than a decade of economic growth. The credit squeeze that has followed the collapse of the "sub-prime" housing loans market

in the USA is having global consequences. As the availability of bank loans has dried up, does this mean the end of private equity as we know it?

The answer lies in the undoubted success of private equity in acting as an alternative to a full stock exchange listing. While bank borrowings are much more difficult to come by, there is still a great deal of money within the private equity system that will find its way into investment. It may well be that we have seen the last of the really big private equity acquisitions, funded largely by bank loans, at least for a while. But pension funds, mutual funds and insurance companies still generate money that has to be invested. It is merely the scale of acquisitions and investments that might change.

This was confirmed by a neighbor, who is a partner in one of the smaller UK private equity firms, **Risk Capital Partners**. **RCP** has just bought **Borders** book stores in the UK and Ireland. To him, all that the credit squeeze has done is alter the way some of the deals are put together. So private equity has arrived, and will be with us for as long as investors have money. It is just another chapter in the long story of adventures in capitalism. 🐻